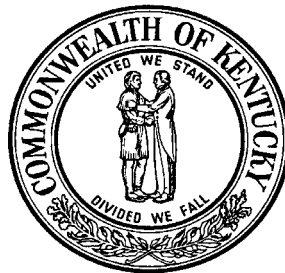


**LETTER FROM THE AUDITOR OF PUBLIC ACCOUNTS
DEPARTMENT OF MILITARY AFFAIRS**

**In Reference to the Statewide Single Audit
of the Commonwealth of Kentucky**

For the Fiscal Year Ended June 30, 2004



**CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS
www.auditor.ky.us**

**105 SEA HERO ROAD, SUITE 2
FRANKFORT, KY 40601
TELEPHONE (502) 573-0050
FACSIMILE (502) 573-0067**

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CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

Major General Donald C. Storm, Adjutant General
Department of Military Affairs

MANAGEMENT LETTER

Pursuant to KRS 43.090 (1), which states, "[i]mmediately upon completion of each audit and investigation, except those provided for in KRS 43.070, the Auditor shall prepare a report of his findings and recommendations," we are providing this letter to the Department of Military Affairs to comply with KRS 43.090.

This letter presents the results of the work performed at the Department of Military Affairs, as part of our annual Statewide Single Audit of the Commonwealth of Kentucky.

In planning and performing our audit over compliance with requirements applicable to major federal programs, for the year ended June 30, 2004, we considered the Department of Military Affairs' internal control in order to determine our auditing procedures for the purpose of expressing an opinion on compliance with requirements applicable to each major federal program and to report on internal control over compliance in accordance with Office of Management and Budget (OMB) Circular A-133 and on the Schedule of Expenditures of Federal Awards (SEFA).

We noted certain instances of noncompliance with requirements applicable to major federal programs we considered to be reportable under standards established by OMB Circular A-133.

We noted certain matters involving internal control over compliance and its operation that we considered to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control over compliance that, in our judgment, could adversely affect the Department of Military Affairs' ability to administer a major federal program in accordance with the applicable requirements of OMB Circular A-133.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that a noncompliance may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.



Major General Donald C. Storm, Adjutant General
Department of Military Affairs
(Continued)

Our consideration of internal control would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. In addition, because of inherent limitations in internal control, errors or fraud may occur and not be detected by such controls. However, we noted certain reportable conditions that we believe to be material weaknesses.

As part of our audit of the Commonwealth's basic financial statements, we also performed tests of the Department of Military Affairs' compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. The results of those tests disclosed five instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Some findings are Other Matters that we have included in this letter to communicate with management in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*.

Included in this letter are the following:

- ◆ Acronym List
- ◆ Schedule of Expenditures of Federal Awards
- ◆ Notes to the Schedule of Expenditures of Federal Awards
- ◆ Findings and Recommendations (Federal Noncompliance, Reportable Conditions, Material Weaknesses and Other Matters)
- ◆ Summary Schedule of Prior Audit Findings

We have issued our Statewide Single Audit of the Commonwealth of Kentucky that contains the Department of Military Affairs' findings, as well as those of other agencies of the Commonwealth. This report can be viewed on our website at www.auditor.ky.gov.

This letter is intended solely for the information and use of management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,



Crit Luallen
Auditor of Public Accounts

February 28, 2005

LIST OF ABBREVIATIONS/ACRONYMS

AFNS	Automated Flood Warning System
AMSCO	Army Management Structure Codes
AYOM	MARS Program Budget Unit
CFDA	Catalog of Federal Domestic Assistance
CFR	Code of Federal Regulations
Commonwealth	Commonwealth of Kentucky
DMA	Department of Military Affairs
DMAR	Department of Military Affairs Regulations
DOJ/OJP	U. S. Department of Justice, Office of Justice Programs
FMO	Facilities Management Officer
FLSA	Fair Labor Standards Act
FY	Fiscal Year
FFY	Federal Fiscal Year
FYE	Fiscal Year Ended
HAZMAT	Hazardous Material
IAW	In Accordance With
ID	Identification
IMF	Installation Management Fund
KAR	Kentucky Administrative Regulations
KRS	Kentucky Revised Statutes
KyDEM	Kentucky Department of Emergency Management
MARS	Management Administrative Reporting System
MA	Department of Military Affairs
NA	Not Applicable
OMB	Office of Management and Budget
O&M	Operations and Maintenance Projects
R&D	Research and Development Programs
RRT	Regional Response Team
SCS	Type of Building Code
SEFA	Schedule of Expenditures of Federal Awards
SFY	State Fiscal Year
TSC	Training Centers
U.S.	United States
USAR	United States Air Force
USPFO	United States Property and Fiscal Officer
UTES/MATES/AASF	Types of Building Code
WMD	Weapons of Mass Destruction

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2004**

CFDA # Program Title	Expenditures		Provided to Subrecipient
	Cash	Noncash	
DEPARTMENT OF MILITARY AFFAIRS			
U.S. Department of Commerce			
Direct Program:			
11.450 Automated Flood Warning Systems (AFWS)	\$	54,014	
U.S. Department of Defense			
Direct Programs:			
12.400 Military Construction, National Guard		245,684	
12.401 National Guard Military Operations and Maintenance (O&M) Projects		10,816,969	
12.404 National Guard Civilian Youth Opportunities		1,790,996	
U.S. Department of Labor			
Passed Through From Cabinet for Workforce Development:			
17.259 WIA Youth Activities		294,442	
17.267 WIA Incentive Grants - Section 503 Grants to States		298,105	
U.S. Department of Transportation			
Direct Programs:			
20.703 Interagency Hazardous Materials Public Sector Training and Planning Grants		172,467	
U.S. Department of Energy			
Direct Programs:			
81.106 Transport of Transuranic Wastes to the Waste Isolation Pilot Plant: States and Tribal Concerns, Proposed Solutions (Note 3)			
U.S. Department of Education			
Passed Through From Department of Education:			
84.002 Adult Education State Grant Program		125,363	

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2004**

U.S. Department of Health and Human Services

Passed Through From Cabinet for Health Services:

93.283	Centers for Disease Control and Prevention - Investigations and Technical Assistance	195,852	
93.982	Mental Health Disaster Assistance and Emergency Mental Health	184,691	160,410

U.S. Department of Homeland Security

Direct Programs:

97.004	State Domestic Preparedness Equipment Support Program	11,166,939	
97.021	Hazardous Materials Assistance Program	3,966	
97.029	Flood Mitigation Assistance (Note 3)		22,239
97.032	Crisis Counseling	161,118	47,671
97.035	Individual and Family Grants	371	
97.036	Public Assistance Grants (Note 2)	27,113,411	26,527,216
97.039	Hazard Mitigation Grant	3,399,482	2,670,304
97.040	Chemical Stockpile Emergency Preparedness Program	5,205,920	4,596,766
97.042	Emergency Management Performance Grants	2,904,295	1,654,566
97.047	Pre-Disaster Mitigation	177,202	177,202
97.051	State and Local All Hazards Emergency Operations Planning	1,259,623	996,518
97.052	Emergency Operations Centers	7,782	
97.053	Citizen Corps	300,706	205,886
97.054	Community Emergency Response Teams	150,665	143,750

TOTAL DEPARTMENT OF MILITARY AFFAIRS

\$	66,030,063	\$	37,202,528
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NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2004

Note 1 - Purpose of the Schedule and Significant Accounting Policies

Basis of Presentation - OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires a Schedule of Expenditures of Federal Awards showing each federal financial assistance program as identified in the *Catalog of Federal Domestic Assistance*. The accompanying schedule includes all federal grant activity for the Department of Military Affairs and is presented primarily on the basis of cash disbursements as modified by the application of KRS 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed.

KRS 45.229 provides that the Finance and Administration Cabinet may, "for a period of thirty (30) days after the close of any fiscal year, draw warrants against the available balances of appropriations made for that fiscal year, for the payment of expenditures incurred during that year or in fulfillment of contracts properly made during the year, but for no other purpose." However, there is an exception to the application of KRS 45.229 in that regular payroll expenses incurred during the last pay period of the fiscal year are charged to the next year.

The basic financial statements of the Commonwealth are presented on the modified accrual basis of accounting for the governmental fund financial statements and the accrual basis of accounting for the government-wide, proprietary fund, and fiduciary fund financial statements. Therefore, the schedule may not be directly traceable to the basic financial statements in all cases.

Noncash assistance programs, where applicable, are not reported in the basic financial statements of the Commonwealth for FY 04.

Inter-agency Activity - Certain transactions relating to federal financial assistance may appear in the records of more than one (1) state agency. To avoid the overstatement of federal expenditures, the following policies were adopted for the presentation of the schedule:

- (a) Federal moneys may be received by a state agency and passed through to another state agency where the moneys are expended. Except for pass-throughs to state universities as discussed below, this inter-agency transfer activity is reported by the agency expending the moneys.

State agencies that pass federal funds to state universities report those amounts as expenditures.

- (b) Federal moneys received by a state agency and used to purchase goods or services from another state agency are reported in the schedule as an expenditure by the purchasing agency only.

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2004

Note 2 - Type A Programs

Type A programs for the Commonwealth mean any program for which total expenditures of federal awards exceeded \$20 million for FY 04. The Department of Military Affairs had the following cash programs that met the Type A program definition for FY 04, some of which were administered by more than one (1) state agency. Certain component units and agencies audited by certified public accounting firms had lower dollar thresholds. The Commonwealth identified clusters among the Type A programs by gray shading. The Type A program was:

<u>CFDA #</u>	<u>Program Title</u>	<u>Expenditures</u>
97.036	Public Assistance Grants	\$ <u>27,113,411</u>
Total Type A Programs:		<u>\$ 27,113,411</u>

Note 3 - Zero Expenditure Programs

These programs had no expenditures related to the Department of Military Affairs during FY 04. The zero expenditure programs included programs with no activity during the year, such as old programs not officially closed out or new programs issued late in the fiscal year. They also included programs with activity other than expenditures.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Reportable Conditions Relating to Internal Controls and/or Reportable Instances of Noncompliance

FINDING 04-MA-01: The Department Of Military Affairs Should Develop Internal Control Procedures To Retain The Documentation Used To Compute The Payroll Cost Allocation Plan

State Agency: Department of Military Affairs

Federal Program: CFDA 12.401 – National Guard Military Operations And Maintenance (O&M) Projects

Federal Agency: U.S. Department of Defense

Pass-Through Agency: Not Applicable

Compliance Area: Allowable Costs / Cost Principles

Amount of Questioned Costs: None

Military Affairs has developed and uses a Cost Allocation Plan to distribute payroll charges for employees who can have all or part of their salary charged to federal programs. Participation rates originate in three ways. One component (titled VAS2) involves employees chargeable directly to one of the Cooperative Agreements between the state and federal government. Another component (titled FAC2 – primarily Frankfort employees who work on various Cooperative Agreements) involves computing the documents examined for each area and charging the percentage worked in each area as the participation rate. The final component (titled GMM2) involves employees who work at the various armories throughout the state in support of federal activities.

We randomly selected 45 employees to examine the underlying documentation supporting the various participation rates and noted the following (relating to FAC2):

- Six instances where the participation rates were agreed to an agency prepared summary sheet. However, neither the underlying computerized files nor the paper copies had been retained so that we could verify how these percentages were computed.
- Fifteen instances where Military Affairs did not provide documentation for the participation rates charged.
- Three instances where the participation rates were agreed to an agency prepared summary sheet, however, at least one of the participation rate percentages were not listed on this summary page. Again, as noted above, neither the underlying computerized files nor the paper copies had been retained so that we could verify how these percentages were computed.

Also, Military Affairs did not have detailed written procedures to explain how the FAC2 participation rates were compiled.

The employee who prepared the FAC2 cost allocation plan for state fiscal years 03 & 04 left the agency. The computerized files used to compute the participation rates were not retained and evidently a hard copy was not prepared for all the files.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Controls and/or
Reportable Instances of Noncompliance*****FINDING 04-MA-01: The Department Of Military Affairs Should Develop Internal Control Procedures To Retain The Documentation Used To Compute The Payroll Cost Allocation Plan (Continued)**

OMB Circular A-87 Attachment A, Part C, j. requires expenditures to be adequately documented.

Agencies should prepare detailed written procedure for all vital processes within an agency. These written procedures would allow replacement employees or management to continue performing crucial processes in a consistent and functional manner.

Recommendation

We recommend Military Affairs implement the following:

- Develop a policy to retain detailed supporting documentation to support all costs charged to federal programs.
- Develop detailed written procedures of the payroll cost allocation plan.

Management Response and Corrective Action Plan

Management's goal for the internal control process, within the Dept. of Military Affairs (DMA), is to obtain reasonable assurance that material misstatements will not occur or will be detected in a timely manner. The department's internal control objective for allowable cost / cost principles is to provide reasonable assurance that Federal grant awards are expended only for allowable activities and that the costs of goods and services charged to Federal grant awards are allowable and in accordance with the applicable cost principles. The department's current internal control environment, effected by executive management, establishes management's full support of ethical, efficient, and effective internal control activities and sets a positive tone for correction of identified deficiencies.

*Based on the auditor's findings, DMA management has conducted an analysis of the overall risk environment currently facing the department that identified the fact that resource constraints have increased the overall risk to compliance standard accomplishment. From SFY2002 to SFY2004, DMA's federal grant awards disbursement amount increased by 190% yet at the same time DMA lost 11% of its full time state employee workforce in the last budget reduction cycle due to inability to fully fund available positions from appropriated state General Funds. While DMA management, at all levels, has taken steps to mitigate the increased risk, the fundamental issue remains that doing more with less can adversely effect the risk of noncompliance to internal control standards. Managing this increased risk, without addressing the systemic problem directly, is a very difficult management challenge. **Auditor Note: The second paragraph was attached to each agency response.***

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Reportable Conditions Relating to Internal Controls and/or Reportable Instances of Noncompliance

FINDING 04-MA-01: The Department Of Military Affairs Should Develop Internal Control Procedures To Retain The Documentation Used To Compute The Payroll Cost Allocation Plan (Continued)

Management Response and Corrective Action Plan

DMA concurs with the auditor's finding and has developed a corrective action plan designed to restore compliance and insure future compliance.

The Division of Facilities Management's Cost Allocation Administrator has detailed a corrective action task list and has already initiated action to correct the findings as described below:

- (1) Effective with the Federal Budget for FFY05, the Facilities Division has established a uniform method to calculate the allocation percentages for Skilled Trades, Property Management, Administrative Services, Administrative Supervisors and Managers, and Reimbursement Administrative Services and to retain source documentation of these direct Cost Allocation calculations.*
- (2) No later than July 31st annually, the Facilities Division Cost Allocation administrator shall review the job duties of all Facilities employees with the Administrative Branch Manager or Assistant Director to assign each employee to a funding source (100% federal, direct cost allocation, or 100% state) based on documented evidence of prior state fiscal year work performed directly for a federal grant program. Employees whose work is exclusively for a federal grant program shall be categorized as 100% federally reimbursable IAW the federal grant guidelines. Employees who do not perform work, fully or partially, for any federal grant program shall be categorized as 100% state funded. Employees who perform some work or services directly for a federal grant program shall be tabulated via a direct cost allocation process. These employees, whose pay and expenses qualify for direct cost allocation, are further subdivided by functional section:*
 - Skilled Trades: all those employees who's work involves repair and maintenance of facilities*
 - Property Management: all those employees who's work involves supplying all facilities with required equipment and supplies to maintain operations*
 - Administrative Services: all those employees who's work involves central services activities*
 - Administrative Supervisors and Managers: all those employees who supervise the central service activities*
 - Reimbursement Section: all those employees who's work involves the reimbursement of state funds by federal funds – these employees are 100% federally funded and allocated to all federal grant projects*

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Reportable Conditions Relating to Internal Controls and/or Reportable Instances of Noncompliance

FINDING 04-MA-01: The Department Of Military Affairs Should Develop Internal Control Procedures To Retain The Documentation Used To Compute The Payroll Cost Allocation Plan (Continued)

Management Response and Corrective Action Plan

(3) *For each sub-category of direct Cost Allocation personnel, the appropriate reports shall be gathered to document the proportional direct cost benefit using the same state fiscal year time period for all historical reports:*

- *Skilled Tradesmen: Historical work order transaction data shall be used to support allocated direct labor costs. Each work order entered into the system is assigned a Fund ID. These 'Fund ID's represent the program responsible for the cost of repairs.*
- *Property Management: These employees do not use any definitive documentation that tracks their activities by program or facility. Therefore, the best allocation method shall use the square footage of reimbursed facilities divided by total square footage of all facilities. The Federal government provides both the square footage of each facility and the Agreement code for each facility. Training centers, code TSC, and UTES/MATES/AASF buildings, code SC8, are all funded through AYOM training. Logistical facilities, code SCS, are funded through AYOM log.*
- *Administrative Services Section: Historical MRDB transaction data shall be used to support allocated central service costs. These reports count the number of transaction line entries made to the specialized ledgers. These reports shall exclude any document categories not applicable to facilities. For example, all documents prepared or processed by Emergency Management are excluded because the facilities division does not work on or use Emergency Management projects and documents. These reports include the percent of transaction lines made for a given project / CFDA program / CFDA agency as compared to all transactions made within the reporting period.*
- *Administrative Supervisors and Managers: This group uses the same reports as Administrative Services Section explained above. The only difference is that upper management is not reimbursable through all programs. Both Supervisors and Managers are charged to the Army O&M project based upon the allocation percent. However, reimbursement is only allowable for the Supervisors under the Army Environmental grant program agreement.*

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Controls and/or
Reportable Instances of Noncompliance*****FINDING 04-MA-01: The Department Of Military Affairs Should Develop Internal Control Procedures To Retain The Documentation Used To Compute The Payroll Cost Allocation Plan (Continued)**

Management Response and Corrective Action Plan

- *Reimbursement Section: Historical MRDB transaction data is used to support allocated reimbursement personnel costs. The reports count the number of transaction line entries made to the specialized ledgers. The reports excluded any document categories not applicable to reimbursement. For example, USAR projects are included with the Administrative Services Section, but not on the Reimbursement reports. These reports include the percent of transaction lines made for a given project / CFDA program / CFDA agency as compared to all transactions made within the reporting period.*
- (4) *No later than July 31st annually, the Facilities Division Cost Allocation Administrator shall run and file all source data MRDB reports which shall be kept in the appropriate folder by the Facilities Division reimbursement section. The Facilities Division Cost Allocation Administrator shall prepare a direct cost allocation memo, based on the MRDB source data reports, and send it to the Facilities Division Director and the federal grantor (FMO) for approval and implementation on October 1st annually. This memo will contain work sheets that provide the indirect cost allocation by individual employee as based on the source documentation reports.*

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Reportable Conditions Relating to Internal Controls and/or Reportable Instances of Noncompliance

FINDING 04-MA-02: The Department Of Military Affairs Should Implement Internal Control Procedures To Comply With NGR 5-1/ANGI 63-101 Relating To Program Income For The National Guard Program

State Agency: Department of Military Affairs

Federal Program: CFDA 12.401 – National Guard Military Operations And Maintenance (O&M) Projects

Federal Agency: U.S. Department of Defense

Pass-Through Agency: Not Applicable

Compliance Area: Program Income

Amount of Questioned Costs: None

Federal regulation NGR 5-1/ANGI 63-101 allows income from the rental of state-owned, federal supported armories to be used to maintain the armories. The Division of Facilities Management oversees and monitors the financial operation of each armory via review of the monthly (in some instances quarterly) Installation Management Fund Cash Account & Operating Statement. These reports should include bank statements, cancelled checks, rental agreements and detail supporting documentation for all expenditures. Based on information provided by the agency, the armories handled over \$220,000 in these accounts for FY 04.

We examined the monthly reports filed during FYE 6/30/04 for five of the armories and noted the following:

- Per Military Affairs personnel, some state employees have been compensated for serving as armory managers. This would appear to violate the state's Conflict of Interest Policy found in KRS 11A.040 (4) & (5) and U. S. Department of Labor overtime laws. KRS 11A.040 (4) and (5) state "A public servant shall not knowingly himself or through any business in which he owns or controls an interest of more than five percent (5%), or by any other person for his use or benefit or on his account, undertake, execute, hold, bid on, negotiate, or enjoy, in whole or in part, any contract, agreement, lease, sale, or purchase made, entered into, awarded, or granted by the agency by which he is employed or which he supervises, subject to the provisions of KRS 45A.340. (5) A public servant shall not knowingly accept compensation, other than that provided by law for public servants, for performance of his official duties without the prior approval of the commission." Also, 101 KAR 2:102 Section 5 (c) which incorporates U. S. Department of Labor regulations, states "An employee deemed to be "nonexempt" by the provisions of the FLSA shall be compensated for hours worked in excess of forty (40) per week as provided by subparagraphs 1 to 3 of this paragraph."

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Controls and/or
Reportable Instances of Noncompliance*****FINDING 04-MA-02: The Department Of Military Affairs Should Implement Internal Control Procedures To Comply With NGR 5-1/ANGI 63-101 Relating To Program Income For The National Guard Program (Continued)**

- Four of the armories did not consistently submit rental agreements, or any other type of receipt summary, each month to support the amounts deposited. The lack of adequate supporting documentation and the lack of uniquely or prenumbered rental contracts precluded us from determining that all funds received had in fact been deposited. Also, Military Affairs personnel indicated that approximately 95% of the armories have snack and soft drink machines. We noted evidence of snack and soft drink machines for only two of the five armories reviewed. Military Affairs policy DMAR 210-8 Section VI c. states “The Standard Voucher (AGO Ky Form 27-2) when used as a receipt record will have supporting documents attached (rental, contracts, vending deposits, bank deposits, etc.). If supporting documentation is used in the previous report, reference only is required.”
- We could not find documented prior approval for a \$558.60 purchase of tables by the Richmond Armory. Military Affairs policy DMAR 210-8 Section III c. requires prior approval for any non-recurring purchase over \$50.
- The Richmond Armory purchased carpet for \$476.00 but did not provide any supporting documentation. Military Affairs policy DMAR 210-8 Section VI d. requires expenditures to have supporting documentation
- The Owensboro Armory reimbursed an employee twice for the use of their private vehicle. The employee was reimbursed at \$.50 per mile from the Installation Management Fund bank account. Per Military Affairs personnel, this is not an allowable use of armory funds. Reimbursements to employees (federal or state) for mileage should be submitted through the normal travel reimbursement process instead of being paid by the armory fund.
- Many of the armory managers would write checks to themselves for security or clean-up relating to a specific rental event. While this is allowable under current Military Affairs procedures, this process impedes separation of duties and lacks the appearance of an arms-length transaction. Good internal control procedures require that adequate documentation be submitted to allow for the verification of all deposits and expenditures. Also, these procedures would provide for adequate separation of duties and the evidence of an arms-length transaction.
- For four of the five armories tested, the bank statement amounts did not agree to the amounts recorded on the Installation Management Fund Year End Balances Report.
- The Danville Armory received a cold check for the rental of the armory; neither Military Affairs personnel nor we could determine if this had been collected and redeposited.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Controls and/or
Reportable Instances of Noncompliance*****FINDING 04-MA-02: The Department Of Military Affairs Should Implement Internal Control Procedures To Comply With NGR 5-1/ANGI 63-101 Relating To Program Income For The National Guard Program (Continued)**

- We noted several individuals had received over \$600 for services provided (including the armory managers). However, these individuals were not provided with a 1099 Miscellaneous form indicating the amount of taxable wages. Internal Revenue regulations require that anyone providing services totaling over \$600 in a calendar year shall be issued a 1099 Miscellaneous form denoting the non-employee taxable earnings.

When notified of a change in armory managers, Military Affairs sends each manager a packet including sample monthly reports, policies and procedures, blank rental agreements, etc. However, per Military Affairs personnel, due to active duty requirements of the armory managers there is a large turnover in this position. Also, many times armories do not notify Military Affairs on a timely basis of changes in armory managers. These new managers lack familiarity with the required procedures thus creating errors and omissions.

Recommendation

We recommend Military Affairs implement the following:

- Military Affairs should consult with the Executive Branch Ethics Commission to determine if state employees performing certain duties at the armories may be compensated with additional salary as provided by current agency policy. In addition, Military Affairs should consult with the Personnel Cabinet to determine if other wage and applicable labor provisions are being met.
- Require rental agreements, a detail of receipts and/or AGO Form 27-2 to support all deposits for the month. Enough detail should be provided to allow the Military Affairs reviewer to agree documentation to the amount recorded by the bank.
- Develop a process to pre-number rental contracts for each armory and perform a monthly reconciliation to ensure all contracts are accounted for and submitted with the monthly report.
- Military Affairs inquire of all armories as to who has vending revenues and ensuring these funds are being reported on the monthly reports.
- Remind armories to obtain prior approval for purchases over \$50 and to supply supporting documentation for all expenditures.
- Notify armory managers that reimbursements for mileage are not an allowable expenditure.
- Develop a policy requiring review and approval of all payments made to armory managers by their commanding officer or someone else with supervisory responsibilities.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Controls and/or
Reportable Instances of Noncompliance*****FINDING 04-MA-02: The Department Of Military Affairs Should Implement Internal Control Procedures To Comply With NGR 5-1/ANGI 63-101 Relating To Program Income For The National Guard Program (Continued)**

Recommendation

- Ensure amounts recorded on the Installation Management Fund Year End Balance Report agree to bank statements.
- Develop a system, either at the armory or at Military Affairs, tracking amounts received by individuals and ensuring that the proper tax forms are prepared. Each person paid for providing services to the armory should complete a W-9 prior to any payment being made.

Management Response and Corrective Action Plan

Management's goal for the internal control process, within the Dept. of Military Affairs (DMA), is to obtain reasonable assurance that material misstatements will not occur or will be detected in a timely manner. The department's internal control objective for program income is to provide reasonable assurance that federal grant related program income is correctly earned, recorded, and used in accordance with the federal grant program requirements. The department's current internal control environment, effected by executive management, establishes management's full support of ethical, efficient, and effective internal control activities and sets a positive tone for correction of identified deficiencies.

DMA concurs with the auditor's finding and has developed a corrective action plan designed to restore compliance and insure future compliance.

The Division of Facilities Management's IMF Fund Administrator has detailed a corrective action task list and has already initiated action to correct the findings as described below:

- (1) The Facilities Management Division has already submitted an analysis request to Mr. Jo Ledford, with the Executive Branch Ethics Commission, on the issue of the ten percent armory manager compensation wage. We will make the appropriate adjustments to the Installation Management Fund Rules & Regulations according to Mr. Ledford's ruling. The estimated completion date for this task is June 30, 2005.*

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Controls and/or
Reportable Instances of Noncompliance*****FINDING 04-MA-02: The Department Of Military Affairs Should Implement Internal Control Procedures To Comply With NGR 5-1/ANGI 63-101 Relating To Program Income For The National Guard Program (Continued)**

Management Response and Corrective Action Plan

- (2) *Effective immediately, all armory managers and others who perform any armory rental security or clean-up shall be required to complete a W-9 form in order to track the annual income collected through armory rental clean-up, security and the ten percent armory manager compensation wage. Armory managers will be required to complete a separate AGO 27-2 form to show their monthly compensation wage and any hours of security & clean up they may have done during/after an armory rental. If the armory manager chose to allow another employee to perform the maintenance and security, he or she is to submit an AGO 27-2 form for that person, to include the hours worked during the armory rental. The Facilities Division IMF Fund Administrator shall track this data on a monthly basis according to the amounts reported on each statement. This will allow the Facilities Division IMF Fund Administrator to track the annual income these employees have earned through these services and will ensure that the proper tax documents are provided. The estimated completion date for this task is December 31, 2005.*
- (3) *Concerning the deposits made by armory managers, more detailed documentation shall be required by the Facilities Division IMF Fund Administrator to show the source of all deposited funds. Beginning 1 July 2005 armory managers will be required to provide a detailed breakdown of deposited funds on an AGO 27-2 form. The Facilities Division IMF Fund Administrator shall also require that all rental agreements be attached to the monthly statements for the month during which the rental took place. For more efficient tracking purposes, the Facilities Division IMF Fund Administrator shall order pre-numbered rental agreements for armory managers to begin using at the start of SFY 2006. This will ensure that all agreements are accounted for. The estimated completion date for this task is June 30, 2005.*
- (4) *Beginning with the SFY2005 IMF Year End Balance Report, the Facilities Division IMF Fund Administrator shall ensure the IMF Year End Balance Report corresponds to the monthly bank statements. The estimated completion date of this task is June 30, 2005.*
- (5) *No later than March 31, 2005, Facilities Management Division shall make the appropriate changes to the Installation Management Fund Rules & Regulations to include all of the above-mentioned revisions.*

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Controls and/or
Reportable Instances of Noncompliance*****FINDING 04-MA-02: The Department Of Military Affairs Should Implement Internal Control Procedures To Comply With NGR 5-1/ANGI 63-101 Relating To Program Income For The National Guard Program (Continued)**

Management Response and Corrective Action Plan

- (6) *No later than June 30, 2005, the Facilities Division IMF fund administrator shall meet with all armory managers to discuss the changes to the IMF Rules & Regulations. Items for discussion shall include the requirements of each monthly statement and what a complete statement should consist of, stress the importance of the rules & regulations, and answer and address any questions or concerns they may have.*
- (7) *No later than June 30, 2005, the Facilities Division IMF Fund Administrator shall verify which armories have vending machines and work with the DMA Procurement Officer to get all Armories on state contract for vending services and have all earnings checks sent through the Facilities Division IMF Fund Administrator for deposit in the appropriate Armory IMF fund.*

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Controls and/or
Reportable Instances of Noncompliance*****FINDING 04-MA-03: The Department Of Military Affairs Should Implement Internal Controls To Retain Supporting Documentation For PX Documents**

State Agency: Department of Military Affairs

Federal Program: CFDA 97.036 – Public Assistance Grants

Federal Agency: U.S. Department of Homeland Security

Pass-Through Agency: Not Applicable

Compliance Area: Allowable Costs/Cost Principles

Amount of Questioned Costs: \$98,678.70

The MARS user guide for Projects and Grants allows the use of PX documents to record indirect transactions for a project or grant. These charges may include allocated administrative expenses; items purchased in bulk in prior fiscal years and used in the current fiscal year; payments for administrative expenses relating to disasters incurred in a previous fiscal year; or recording amounts incurred by subrecipient state agencies. The affected division will prepare the PX document and along with supporting documentation forward to the Division of Administrative Services for final MARS approval.

We tested 11 PX documents, six relating to the 97.036 - Public Assistance Grants Program and five relating to the 12.401 National Guard Program and noted the following:

- One document, totaling \$98,721.52, could not be located
- One document, totaling \$(42.82), did not have supporting documentation
- Two documents did not have the necessary documentation from the prior fiscal year to allow us to determine where and when the original charge had been made (no questioned costs).

All the errors noted above relate to the 97.036 - Public Assistance Program. The PX document was used 19 times, totaling \$681,327.77. As noted above, four documents were in error or 21% of the total documents and the unsupported expenditures (questioned costs) equaled 14.5% of the dollar amount charged. OMB Circular A-87 Attachment A, Part C, j. requires expenditures “be adequately documented.”

Agency policy requires PX documents be sent to Administrative Services Division with all applicable supporting documentation. This policy was not followed and resulted in our questioning the costs for the missing documentation. Also, Military Affairs has a policy requiring all PX documents be sent to the Administrative Services Division for final approval. This policy requires either the Division preparing the PX or Administrative Services make a copy of all the PX documents and the supporting documentation.

Recommendation

We recommend Military Affairs reinforce and adhere to the policy of making copies of all PX documents and applicable supporting documentation.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Controls and/or
Reportable Instances of Noncompliance*****FINDING 04-MA-03: The Department Of Military Affairs Should Implement Internal Controls To Retain Supporting Documentation For PX Documents (Continued)**

Management Response and Corrective Action Plan

Management's goal for the internal control process, within the Dept. of Military Affairs (DMA), is to obtain reasonable assurance that material misstatements will not occur or will be detected in a timely manner. The department's internal control objective for allowable cost / cost principles is to provide reasonable assurance that Federal grant awards are expended only for allowable activities and that the costs of goods and services charged to Federal grant awards are allowable and in accordance with the applicable cost principles. The department's current internal control environment, effected by executive management, establishes management's full support of ethical, efficient, and effective internal control activities and sets a positive tone for correction of identified deficiencies.

DMA concurs with the auditor's finding and has developed a corrective action plan designed to restore compliance and insure future compliance.

The Administrative Services Fiscal Manager has detailed a corrective action task list and shall initiate action to correct the findings as described below:

Effective immediately, all Advantage disbursement and non-accounting PX documents will be prepared and processed by a DMA division utilizing Advantage level 1 & 2 approval and then forwarded to the Admin Services Fiscal Manager for final processing and level 3 agency approval. The Admin Services Fiscal Manager, exercising final agency approval, will insure that all documents have appropriate source documentation attached before final approval and that, upon final approval, primary and source documents are properly filed in the Agency's official financial files.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Material Reportable Conditions Relating to Internal Controls and/or
Material Reportable Instances of Noncompliance*****FINDING 04-MA-04: The Department Of Military Affairs Should Develop An Internal Control System For the State Domestic Preparedness Equipment Assistance Program To Comply With OMB Circular A-133 Compliance Requirements**

State Agency: Department of Military Affairs

Federal Program: CFDA 97.004 – State Domestic Preparedness Equipment Support Program

Federal Agency: U.S. Department of Homeland Security

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: None

The State Domestic Preparedness Equipment Support Program did not establish the following internal control procedures to ensure compliance with the subrecipient monitoring requirements found in OMB Circular A-133, including:

- Advising subrecipients (except for general language in the Memorandum of Agreement) of their responsibility to obtain an audit of Federal awards exceeding \$300,000 in state FY 03 and \$500,000 in state FY 04;
- Establishing a tracking system to determine which subrecipients were required to have an A-133 audit prepared which includes all the required components;
- Establishing a monitoring system to determine if subrecipients have established adequate internal control procedures over Federal awards to ensure federal funds are used for authorized purposes in compliance with laws and regulations;
- Performing desk reviews of A-133 subrecipient audits submitted;
- Resolving audit findings within six months after receipt of the subrecipient audit report and ensuring the subrecipient took timely corrective action;
- Reconciling the amount of Federal awards reported in subrecipient audits to amounts in the MARS accounting system.

State Domestic Preparedness Equipment Support Program has experienced a significant increase in the amount of federal funds received and a corresponding increase in the amount passed through to subrecipients. Military Affairs did not implement procedures to ensure subrecipients complied with the audit and monitoring requirements of OMB Circular A-133.

OMB Circular A-133 Subpart D (d) requires the recipients of federal awards that pass these funds through to subrecipients to implement internal controls for the following areas:

- (1) Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year, if the award is R&D, and name of Federal agency.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Material Reportable Conditions Relating to Internal Controls and/or
Material Reportable Instances of Noncompliance*****FINDING 04-MA-04: The Department Of Military Affairs Should Develop An Internal Control System For the State Domestic Preparedness Equipment Assistance Program To Comply With OMB Circular A-133 Compliance Requirements (Continued)**

- (2) Advise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements as well as any supplemental requirements imposed by the pass-through entity.
- (3) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.
- (4) Ensure that subrecipients expending \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.
- (5) Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.
- (6) Consider whether subrecipient audits necessitate adjustment of the pass-through entity's own records.
- (7) Require each subrecipient to permit the pass-through entity and auditors to have access to the records and financial statements as necessary for the pass-through entity to comply with this part.

Recommendation

We recommend Military Affairs establish procedures to comply with OMB Circular A-133.

Management's Response and Corrective Action Plan

Management's goal for the internal control process, within the Dept. of Military Affairs (DMA), is to obtain reasonable assurance that material misstatements will not occur or will be detected in a timely manner. The department's internal control objective for sub-recipient monitoring is to provide reasonable assurance that Federal grant award information and compliance requirements are identified to sub-recipients, sub-recipient activities are monitored, sub-recipient audit findings are resolved, the impact of any sub-recipient noncompliance on the pass-through entity is evaluated, and sub-recipients obtained required audits and take appropriate corrective action on audit findings. The department's current internal control environment, effected by executive management, establishes management's full support of ethical, efficient, and effective internal control activities and sets a positive tone for correction of identified deficiencies.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Material Reportable Conditions Relating to Internal Controls and/or
Material Reportable Instances of Noncompliance*****FINDING 04-MA-04: The Department Of Military Affairs Should Develop An Internal Control System For the State Domestic Preparedness Equipment Assistance Program To Comply With OMB Circular A-133 Compliance Requirements (Continued)**

Management's Response and Corrective Action Plan

DMA concurs with the auditor's finding and has developed a corrective action plan designed to restore compliance and insure future compliance.

The Kentucky Division of Emergency Management's State Domestic Preparedness Equipment Support Program, as the federal grantee for the federal grant program, has developed a corrective action plan and has already initiated actions to correct the findings as described below:

- 1. Effective immediately, all KyDEM grant programs, to include the State Domestic Preparedness Equipment Support Program, shall utilize the grant's Master Agreement MARS document to incorporate all federal grant regulatory compliance information, to include OMB Circular A-133 audit and other requirements, is formally and contractually identified for sub-recipient compliance.*
- 2. KyDEM has already issued written internal division policy #133-1, Sub-Recipient Audits / Monitoring, to establish a divisional monitoring system to determine if sub-recipients have established adequate internal control procedures over Federal awards to ensure federal funds are used for authorized purposes in compliance with laws and regulations. The policy was provided to the auditors.*
- 3. Effective the start of state fiscal year 2005 each KyDEM section responsible for the dispersion of federal grant funds, to include the State Domestic Preparedness Equipment Support Program, shall review the audits for their federal program sub-recipients, when received, to comply with OMB Circular A-133 and division policy #113-1, or later approved version. A memo record of this review shall be provided to the KyDEM Assistant Director for each sub-recipient audit reviewed no later than August 31st annually. When applicable, a management decision on the correction / non-correction of a sub-recipient audit finding will be issued the KyDEM Assistant Director within six months after the receipt of the sub-recipient audit report.*

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Material Reportable Conditions Relating to Internal Controls and/or
Material Reportable Instances of Noncompliance*****FINDING 04-MA-04: The Department Of Military Affairs Should Develop An Internal Control System For the State Domestic Preparedness Equipment Assistance Program To Comply With OMB Circular A-133 Compliance Requirements (Continued)**

Management's Response and Corrective Action Plan

4. *By June 30, 2005, KyDEM shall staff a position using federal administrative cost grant funds to perform desk reviews of sub-recipient audit reports and to work with the sub-recipients to resolve audit findings within six months after receipt of the sub-recipient audit report and ensure the sub-recipient takes timely corrective action.*
5. *At the end of each state fiscal year and upon receipt of sub-recipient audit reports for that year, each KyDEM section responsible for the dispersion of federal grant funds, to include the State Domestic Preparedness Equipment Support Program, shall reconcile the amount of Federal awards reported in sub-recipient audits to amounts in the MARS accounting system for the same CFDA number and period of time as the sub-recipient's audit and a memo record of this reconciliation with supporting MARS financial documents shall be provided to the KyDEM Assistant Director no later than August 31st annually.*

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Material Reportable Conditions Relating to Internal Controls and/or
Material Reportable Instances of Noncompliance*****FINDING 04-MA-05: The Department Of Military Affairs Should Follow
Established Internal Controls Used To Ensure Compliance With OMB Circular
A-133 Compliance Requirements For The Public Assistance Program**

State Agency: Department of Military Affairs

Federal Program: CFDA 97.036 – Public Assistance Grants

Federal Agency: U.S. Department of Homeland Security

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: None

The Public Assistance Program did not establish the following procedures to ensure compliance with many of the audit and monitoring requirements found in OMB Circular A-133, including:

- Advising all subrecipients of their responsibility to obtain an audit of Federal awards exceeding \$300,000 in state FY 03 and \$500,000 in state FY 04.
- Establishing a monitoring system to determine if subrecipients have established adequate internal control procedures over Federal awards to ensure federal funds are used for authorized purposes in compliance with laws and regulations;
- Performing desk reviews of A-133 subrecipient audits submitted;
- Resolving audit findings within six months after receipt of the subrecipient audit report and ensuring the subrecipient took timely corrective action;
- Reconciling the amount of Federal awards reported in subrecipient audits to amounts in MARS accounting system.

Also, we examined the tracking system used by the Recovery Branch to track whether subrecipients had filed A-133 audits, related findings or comments, risk any status of findings and comments. In our testing of the tracking system, we examined 43 subrecipients and noted that 30 were not listed, two were listed stating that DMA did not provide federal assistance and four subrecipients were listed on the tracking devise but did not list information applicable to the disaster we were testing.

Also, Military Affairs indicated that all subrecipients of federal awards received letters informing them of their audit responsibilities, whether the audit had been completed, whether the audit had findings, and the reasoning for no audit being performed. In our review of 40 public assistance disaster folders we could not locate these letters in 10 instances.

Subrecipient monitoring has been a recurring comment for Military Affairs and in response to these comments, Military Affairs developed detailed procedures to correct past deficiencies. However, these procedures were not implemented until mid December 2004. These procedures were not implemented in time to affect corrections in our audit of state FY 04.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Material Reportable Conditions Relating to Internal Controls and/or
Material Reportable Instances of Noncompliance*****FINDING 04-MA-05: The Department Of Military Affairs Should Follow
Established Internal Controls Used To Ensure Compliance With OMB Circular
A-133 Compliance Requirements For The Public Assistance Program (Continued)**

OMB Circular A-133 Subpart D (d) requires the following:

- 1) Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year, if the award is R&D, and name of Federal agency.
- (2) Advise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements as well as any supplemental requirements imposed by the pass-through entity.
- (3) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.
- (4) Ensure that subrecipients expending \$300,000 (*\$500,000 for fiscal years ending after December 31, 2003*) or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.
- (5) Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.
- (6) Consider whether subrecipient audits necessitate adjustment of the pass-through entity's own records.
- (7) Require each subrecipient to permit the pass-through entity and auditors to have access to the records and financial statements as necessary for the pass-through entity to comply with this part.

Recommendation

We recommend Military Affairs:

- Continue to implement the procedures established to fully comply with OMB Circular A-133.
- Improve the tracking devise to include all subrecipients for all disasters.
- Ensure that each subrecipient receives audit letters and that they are placed in each applicable disaster folder. This information is readily available from a report run by the Chief Administrative Officer.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Material Reportable Conditions Relating to Internal Controls and/or
Material Reportable Instances of Noncompliance*****FINDING 04-MA-05: The Department Of Military Affairs Should Follow
Established Internal Controls Used To Ensure Compliance With OMB Circular
A-133 Compliance Requirements For The Public Assistance Program (Continued)**

Management's Response and Corrective Action Plan

Management's goal for the internal control process, within the Dept. of Military Affairs (DMA), is to obtain reasonable assurance that material misstatements will not occur or will be detected in a timely manner. The department's internal control objective for sub-recipient monitoring is to provide reasonable assurance that Federal grant award information and compliance requirements are identified to sub-recipients, sub-recipient activities are monitored, sub-recipient audit findings are resolved, the impact of any sub-recipient noncompliance on the pass-through entity is evaluated, and sub-recipients obtained required audits and take appropriate corrective action on audit findings. The department's current internal control environment, effected by executive management, establishes management's full support of ethical, efficient, and effective internal control activities and sets a positive tone for correction of identified deficiencies.

DMA concurs with the auditor's finding and has developed a corrective action plan designed to restore compliance and insure future compliance.

The Kentucky Division of Emergency Management's State Domestic Preparedness Equipment Support Program, as the federal grantee for the federal grant program, has developed a corrective action plan and has already initiated actions to correct the findings as described below:

- (1) Effective immediately, all KyDEM grant programs, to include the Federal Disaster Public Assistance Program, shall utilize the grant's Master Agreement MARS document to incorporate all federal grant regulatory compliance information, to include OMB Circular A-133 audit and other requirements, is formally and contractually identified for sub-recipient compliance.*
- (2) KyDEM has already issued written internal division policy #133-1, Sub-Recipient Audits / Monitoring, to establish a divisional monitoring system to determine if sub-recipients have established adequate internal control procedures over Federal awards to ensure federal funds are used for authorized purposes in compliance with laws and regulations. This division policy is attached.*

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Material Reportable Conditions Relating to Internal Controls and/or
Material Reportable Instances of Noncompliance*****FINDING 04-MA-05: The Department Of Military Affairs Should Follow
Established Internal Controls Used To Ensure Compliance With OMB Circular
A-133 Compliance Requirements For The Public Assistance Program (Continued)****Management's Response and Corrective Action Plan**

- (3) *Effective the start of state fiscal year 2005 each KyDEM section responsible for the dispersion of federal grant funds, to include the Federal Disaster Public Assistance Program, shall review the audits for their federal program sub-recipients, when received, to comply with OMB Circular A-133 and division policy #113-1, or later approved version. A memo record of this review shall be provided to the KyDEM Assistant Director for each sub-recipient audit reviewed no later than August 31st annually. When applicable, a management decision on the correction / non-correction of a sub-recipient audit finding will be issued the KyDEM Assistant Director within six months after the receipt of the sub-recipient audit report.*
- (4) *By June 30, 2005, KyDEM shall staff a position using federal administrative cost grant funds to perform desk reviews of sub-recipient audit reports and to work with the sub-recipients to resolve audit findings within six months after receipt of the sub-recipient audit report and ensure the sub-recipient takes timely corrective action.*
- (5) *At the end of each state fiscal year and upon receipt of sub-recipient audit reports for that year, each KyDEM section responsible for the dispersion of federal grant funds, to include the Federal Disaster Public Assistance Program, shall reconcile the amount of Federal awards reported in sub-recipient audits to amounts in the MARS accounting system for the same CFDA number and period of time as the sub-recipient's audit and a memo record of this reconciliation with supporting MARS financial documents shall be provided to the KyDEM Assistant Director no later than August 31st annually.*

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Other Matters Relating to Internal Controls and/or
Instances of Noncompliance*****FINDING 05-MA-06: The Department Of Military Affairs Should Establish Written Procedures For The Preparation Of The Quarterly SF-269 Report**

State Agency: Department of Military Affairs

Federal Program: CFDA 97.004 – State Domestic Preparedness Equipment Support
Program and CFDA 97.036 – Public Assistance Grants

Federal Agency: U.S. Department of Homeland Security

Pass-Through Agency: Not Applicable

Compliance Area: Reporting

Amount of Questioned Costs: None

Federal statutes pertaining to the State Domestic Preparedness Equipment Assistance Program and the Public Assistance Program require the preparation and filing of a quarterly SF-269 Report. The preparation process for both programs' reports involves accounting and reporting on several projects, gathering and analyzing data from detailed MARS reports, and making adjustments and corrections.

Military Affairs does not have written procedures for the SF-269 preparation process. The employee who prepared these reports during our audit period (state FY 04) left the agency and those who remained could not explain to us how these reports were prepared. We were forced to meet with the former employee to determine how these reports were prepared and if the documentation provided supported the entries made.

The process of preparing these reports involves retrieving complex queries from MARS, determining which projects need adjusting, and adding various MARS entries from queries into the amount to record in the report. Without detailed written instructions, any subsequent preparer of the report may include, adjust or combine incorrect amounts, thus creating an erroneous report. All critical processes and systems should have detailed written desk procedures to be used in case an employee leaves the agency or must be absent from work for an extended period of time. These written procedures would allow replacement employees or management to continue performing crucial processes in a consistent and functional manner.

Recommendation

We recommend Military Affairs develop detailed written procedures for the preparation of the SF-269 reports.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Other Matters Relating to Internal Controls and/or
Instances of Noncompliance*****FINDING 05-MA-06: The Department Of Military Affairs Should Establish Written
Procedures For The Preparation Of The Quarterly SF-269 Report (Continued)**

Management's Response and Corrective Action Plan

Management's goal for the internal control process, within the Dept. of Military Affairs (DMA), is to obtain reasonable assurance that material misstatements will not occur or will be detected in a timely manner. The department's internal control objective for federal grant reporting is to provide reasonable assurance that the reports of Federal grant awards submitted to the Federal awarding agency or pass-through entity include all activity of the report period, are supported by underlying accounting or performance records, and are fairly presented in accordance with Federal grant program requirements. The department's current internal control environment, effected by executive management, establishes management's full support of ethical, efficient, and effective internal control activities and sets a positive tone for correction of identified deficiencies.

DMA concurs with the auditor's finding and has developed a corrective action plan designed to restore compliance and insure future compliance.

The Kentucky Division of Emergency Management, as the federal grantee for the federal grant programs, has developed a corrective action plan and has already initiated actions to correct the findings as described below:

The Pre-Audit Manager for KyDEM has already developed detailed written procedures for the preparation of the SF-269 reports which report federal grant activity as required by federal regulatory guidance. These written procedures have been provided to the auditors.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Other Matters Relating to Internal Controls and/or
Instances of Noncompliance*****FINDING 04-MA-07: The Department Of Military Affairs Should Improve Internal Controls Relating To Equipment Management**

State Agency: Department of Military Affairs

Federal Program: CFDA 97.004 – State Domestic Preparedness Equipment Support Program

Federal Agency: U.S. Department of Homeland Security

Pass-Through Agency: Not Applicable

Compliance Area: Equipment and Real Property Management

Amount of Questioned Costs: None

Each Regional Response Team (RRT) is required to submit a semi-annual report that lists the equipment purchased with State Domestic Preparedness Equipment Support Program funds. This detail report should include date purchased, location, quantity, description, serial number, condition and which area manager physically examined the equipment. In our test of the fourteen RRT's we noted the following exceptions with our review of the equipment reports:

- Region One did not list any serial numbers;
- Region Two did not list the condition, date purchased and who physically examined the equipment;
- Region Seven did not record the condition of the equipment;
- Region Nine and Region Thirteen did not list who physically examined the equipment;
- Region Ten did not list any serial numbers or who physically examined the equipment.

Equipment reports should include all requirements of both Military Affairs and federal regulations. 28 CFR 66.32 (d) (1) requires property records to include among other things the serial number and condition of the equipment. Also, the Military Affairs program administrator has instructed the RRTs to record who physically examined each piece of equipment.

In addition, Military Affairs had not developed a procedure for the disposal of equipment purchased. Even though all the equipment is new, we believe this procedure should be developed and disseminated to the regional response teams and local governments. Having this procedure in place would ensure any proceeds from sales were properly accounted for. 28 CFR 66.32 (e) discusses the disposition of federal property, which implies that a procedure should be in place to ensure compliance with stated statutes.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Other Matters Relating to Internal Controls and/or
Instances of Noncompliance*****FINDING 04-MA-07: The Department Of Military Affairs Should Improve Internal Controls Relating To Equipment Management (Continued)**

Recommendation

We recommend Military Affairs:

- Inform the RRTs of the importance of filing a complete equipment report; and
- Develop a procedure for the disposition of equipment, distribute and inform the RRTs of this policy.

Management's Response and Corrective Action Plan

Management's goal for the internal control process, within the Dept. of Military Affairs (DMA), is to obtain reasonable assurance that material misstatements will not occur or will be detected in a timely manner. The department's internal control objective for federal grant acquired equipment is to provide reasonable assurance that proper records are maintained for equipment acquired with Federal grant awards equipment is adequately safeguarded and maintained, disposition or encumbrance of any equipment is in accordance with Federal grant requirements, and the Federal awarding agency is appropriately compensated for its share of any property sold or converted to other use. The department's current internal control environment, effected by executive management, establishes management's full support of ethical, efficient, and effective internal control activities and sets a positive tone for correction of identified deficiencies.

DMA concurs with the auditor's finding and has developed a corrective action plan designed to restore compliance and insure future compliance.

The Kentucky Division of Emergency Management's State Domestic Preparedness Equipment Support Program, as the federal grantee for the federal grant program, has developed a corrective action plan and has already initiated actions to correct the findings as described below:

- (1) *Each of the fourteen WMD/HAZMAT Regional Response Teams (RRT) has already been verbally instructed by the WMD Program manager to purchase a "barcode reader" type of inventory control system that allows for the inventory and reporting required under 28 CFR 66. The WMD Program Manager shall provide formal notification to the RRT's by letter that will occur by March 31, 2005.*

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Other Matters Relating to Internal Controls and/or
Instances of Noncompliance*****FINDING 04-MA-07: The Department Of Military Affairs Should Improve Internal Controls Relating To Equipment Management (Continued)**

Management's Response and Corrective Action Plan

(2) An RRT team status report along with an equipment inventory report is required twice a year by the end of June and December. The WMD Program manager will align the inventory portion of the report with the required data fields as described in 28 CFR 66. Inaccurate or incomplete RRT equipment reports will be returned for corrective action. This inventory alignment will be implemented with the June 2005 Team Status Report. The WMD Program Manager shall have this corrected by July 31, 2005.

A coordinated Disposition of Equipment Policy will be developed and forwarded to the RRT's as part of the Team Status Packet for the June 2005 Team Status Report. This written policy will contain previous verbal instructions given to teams concerning the disposition of equipment no longer needed by the RRT's or when and if an RRT disbands and what equipment is recommended for retention and what equipment is recommended for transfer to other active teams. The WMD Program Manager shall have this completed by May 30, 2005

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Other Matters Relating to Internal Controls and/or
Instances of Noncompliance*****FINDING 04-MA-08: The Department Of Military Affairs Should Improve Internal Controls To Ensure Local Governments Are Not Supplanting Federal Funds With Local Funds**

State Agency: Department of Military Affairs

Federal Program: CFDA 97.004 – State Domestic Preparedness Equipment Support Program

Federal Agency: U.S. Department of Homeland Security

Pass-Through Agency: Not Applicable

Compliance Area: Matching, Level of Effort, Earmarking

Amount of Questioned Costs: None

The State Domestic Preparedness Equipment Support Program provides funds to enhance the ability of state and local governments to respond to various types of disasters. Federal funds must not supplant planned local government equipment purchases, but rather enable these entities to use additional federal funds to purchase additional equipment. As part of the application and approval process Military Affairs personnel inquire of local governments about the supplanting of funds. However, no formal documentation such as local budgets or a written affidavit is obtained to verify the local governments are not supplanting local funds with federal funds.

Military Affairs personnel have relied on oral statements from local government or inquiries by the regional response managers as a basis for ensuring that local governments are not supplanting federal funds with local funds. Military Affairs has taken action whenever word of a possible supplanting of funds has occurred.

According to U. S. Department of Justice, Fiscal Years 2002 & 2003 State Domestic Preparedness Program - Program Guidelines and Application Kits, the state is required to provide a non-supplanting certification. As part of this certification, the guide states “Applicants or grantees may be required to supply documentation certifying that a reduction of non-federal resources occurred for reasons other than receipt or expected receipt of federal funds.” Military Affairs would be unable to provide the referenced documentation based on current procedures.

Also, good internal control procedures dictate that written documentation be obtained to support oral statements. Oral representations should be corroborated by written documentation to ensure the oral statements are accurate.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Other Matters Relating to Internal Controls and/or
Instances of Noncompliance*****FINDING 04-MA-08: The Department Of Military Affairs Should Improve Internal Controls To Ensure Local Governments Are Not Supplanting Federal Funds With Local Funds (Continued)**

Recommendation

We recommend as part of the application process and prior to the payment for equipment purchases that Military Affairs obtain the following:

- Approved budgets for the local government, Military Affairs can review these budgets for any equipment that may have been postponed or removed in subsequent years; or
- A signed, notarized affidavit from the responsible local official stating that the local government has not supplanted federal funds for local funds;
- Other type of documentation providing evidence of non-supplanting of funds, as Military Affairs deems necessary.

Management's Response and Corrective Action Plan

Management's goal for the internal control process, within the Dept. of Military Affairs (DMA), is to obtain reasonable assurance that material misstatements will not occur or will be detected in a timely manner. The department's internal control objective for matching, level of effort, and earmarking is to provide reasonable assurance that federal grant matching, level of effort, or earmarking requirements are met using only allowable funds or costs which are properly calculated and valued. The department's current internal control environment, effected by executive management, establishes management's full support of ethical, efficient, and effective internal control activities and sets a positive tone for correction of identified deficiencies.

DMA concurs with the auditor's finding and has developed a corrective action plan designed to restore compliance and insure future compliance.

The Kentucky Division of Emergency Management's State Domestic Preparedness Equipment Support Program, as the federal grantee for the federal grant program, has developed a corrective action plan and has already initiated actions to correct the findings as described below:

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Other Matters Relating to Internal Controls and/or
Instances of Noncompliance*****FINDING 04-MA-08: The Department Of Military Affairs Should Improve Internal Controls To Ensure Local Governments Are Not Supplanting Federal Funds With Local Funds (Continued)**

Management's Response and Corrective Action Plan

The State Domestic Preparedness Equipment Support Program grant manager will issue an explicit non-supplanting certification that must be signed by each County Treasurer and then notarized before returning to KyDEM for filing. This certification will provide to each County the Grant Guidance on supplanting as outlined by the Department of Justice/Office of Justice Programs and the Department of Homeland Security. The originals will be returned to KyEM and will be maintained in the State Homeland Security Grant file. Copies will be sent to KyDEM Assistant Administrative Director, for filing in the Sub-Recipient Monitoring files located in that office. This process will be completed no later than June 30, 2005.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Other Matters Relating to Internal Controls and/or
Instances of Noncompliance*****FINDING 04-MA-09: The Department Of Military Affairs Should Develop Written Procedures For The Work Order Process**

State Agency: Department of Military Affairs

Federal Program: CFDA 12.401 – National Guard Military Operations and Maintenance (O&M) Projects

Federal Agency: U.S. Department of Defense

Pass-Through Agency: Not Applicable

Compliance Area: Allowable Cost / Cost Principles

Amount of Questioned Costs: None

Military Affairs has developed and uses a work order system to complete various repair and maintenance projects. The work order system tracks, provides on-line monitoring, facilitates the charging of costs to federal programs, etc. We believe this is a critical system to the Division of Facilities operation.

All critical processes and systems should have detailed written desk procedures to be used in case an employee leaves the agency or must be absent from work for an extended period of time. Agencies should prepare detailed written procedure for all vital processes within an agency. These written procedures would allow replacement employees or management to continue performing crucial processes in a consistent and functional manner.

Recommendation

We recommend Military Affairs develop detailed written procedures of the work order process.

Management's Response and Corrective Action Plan

Management's goal for the internal control process, within the Dept. of Military Affairs (DMA), is to obtain reasonable assurance that material misstatements will not occur or will be detected in a timely manner. The department's internal control objective for allowable costs is to provide reasonable assurance that Federal grant awards are expended only for allowable activities and that the cost of goods and services charged to Federal grant awards are allowable and in accordance with the applicable cost principles. The department's current internal control environment, effected by executive management, establishes management's full support of ethical, efficient, and effective internal control activities and sets a positive tone for correction of identified deficiencies.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Other Matters Relating to Internal Controls and/or
Instances of Noncompliance*****FINDING 04-MA-09: The Department Of Military Affairs Should Develop Written
Procedures For The Work Order Process (Continued)**

Management's Response and Corrective Action Plan

DMA concurs with the auditor's finding and has developed a corrective action plan designed to restore compliance and insure future compliance.

The Division of Facilities Management's Work Order System Admin Supervisor has developed a corrective action plan and has initiated action to correct the findings as described below:

By June 30, 2005, the Division of Facilities Management's Work Order System Admin Supervisor shall update the old Work Order systems manual and re-publish the manual to reflect the current information system's procedures for accounting and documenting costs chargeable to federal grant awards. Written procedures will include entering work requests from the web, entering work orders at Facilities level, processing the work request into work orders, approving work orders at the Branch level, Funding work orders at the director level, FMO level and the USP&FO level, editing and closing of the completed work order, explanations on all fields in the work order, ways to find the work order, rejecting a work order, material, labor and salary tables, permission tables, capital construction tables, AMSCO tables, history tables and roll back procedures, support facilities tables, maintenance type tables, printing approved and funded work orders.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Other Matters Relating to Internal Controls and/or
Instances of Noncompliance*****FINDING 04-MA-10: The Department Of Military Affairs Should Improve Internal Controls Relating To The Review Process For the OJP 4587/1 Form Semi-Annual Report**

State Agency: Department of Military Affairs

Federal Program: CFDA 97.004 – State Domestic Preparedness Equipment Support Program

Federal Agency: U.S. Department of Homeland Security

Pass-Through Agency: Not Applicable

Compliance Area: Reporting

Amount of Questioned Costs: None

The FY 2002 State Domestic Preparedness Program Guidelines and Application Kit and the FY 2003 U. S. Department of Homeland Security, Office of Domestic Preparedness Program Guidelines and Application Kit require the submission of a semi-annual OJP Form 4587/1 Progress Report. This report provides an update of the equipment purchase for each grant during the applicable six-month period. We agreed amounts from the tracking workpapers (which had been agreed to MARS) to the 4587/1 for each of the four open grant reports filed covering the period January 1, 2004 through June 30, 2004 and noted the following:

- 4587/1 Report for FY 2002 State Domestic Preparedness Equipment Program – four instances where the amount of equipment purchase was incorrect and two instances where amounts were reported that should not have been. These net errors totaled \$19,422.98.

Also, we noted five instances on the tracking workpapers of equipment purchased during the report period that were not listed on the 4587/1 Report. These omissions totaled \$46,004.12. Per Military Affairs personnel, management does not perform a documented, in depth review of the amounts recorded on this report. Good internal control requires that management develop procedures to ensure reports prepared and submitted are correct.

The FY 2002 State Domestic Preparedness Program Guidelines and Application Kit and the FY 2003 U. S. Department of Homeland Security, Office of Domestic Preparedness Program Guidelines and Application Kit require the submission of OJP Form 4587/1 Progress Reports that reflect accurate data and have been properly approved. An in-depth review by management prior to submission of the reports helps ensure accuracy.

Recommendation

We recommend that Military Affairs establish procedures for a documented independent management review of the 4587/1 Reports.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Other Matters Relating to Internal Controls and/or
Instances of Noncompliance*****FINDING 04-MA-10: The Department Of Military Affairs Should Improve Internal Controls Relating To The Review Process For the OJP 4587/1 Form Semi-Annual Report (Continued)**

Management's Response and Corrective Action Plan

Management's goal for the internal control process, within the Dept. of Military Affairs (DMA), is to obtain reasonable assurance that material misstatements will not occur or will be detected in a timely manner. The department's internal control objective for federal grant reporting is to provide reasonable assurance that the reports of Federal grant awards submitted to the Federal awarding agency or pass-through entity include all activity of the report period, are supported by underlying accounting or performance records, and are fairly presented in accordance with Federal grant program requirements. The department's current internal control environment, effected by executive management, establishes management's full support of ethical, efficient, and effective internal control activities and sets a positive tone for correction of identified deficiencies.

DMA concurs with the auditor's finding and has developed a corrective action plan designed to restore compliance and insure future compliance.

The Kentucky Division of Emergency Management's State Domestic Preparedness Equipment Support Program, as the federal grantee for the federal grant program, has developed a corrective action plan and has already initiated actions to correct the findings as described below:

- (1) No later than June 30 annually, the WMD/HAZMAT Grant Program Manager for the State Domestic Preparedness Equipment Support Program shall develop draft reports, for the remaining federal program funds, with draft budgets and with associated financial extracts and supporting documentation from MARS.*
- (2) The WMD/HAZMAT Grant Program Manager for the State Domestic Preparedness Equipment Support Program shall forward these reports to the KyDEM Pre-Audit Section and the KyDEM Assistant Director for independent management review.*
- (3) Corrected reports will be returned to the WMD/HAZMAT Grant Program Manager for the State Domestic Preparedness Equipment Support Program for filing and submission to the federal grantor agency DOJ/OJP no later than July 31st annually.*

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2004

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Reportable Conditions</u>					
<i>(1) Audit findings that have been fully corrected:</i>					
No findings for this section.					
<i>(2) Audit findings not corrected or partially corrected:</i>					
FY 03	03-MIL-2	The Department Of Military Affairs Should Ensure Subrecipient Monitoring Is Properly Performed	97.036	0	Military Affairs developed extensive procedures which if implemented would expedite compliance. However, these policies were not implemented until January 2005. See 04-MA-05.
FY 02	02-MIL-1	The Department Of Military Affairs Should Ensure Subrecipient Monitoring Is Properly Performed	97.036	0	See 04-MA-05.
FY 01	01-MIL-1	The Department Of Military Affairs Should Ensure Subrecipients Meet OMB Circular A-133 Audit Requirements	97.036	0	See 04-MA-05.
FY 97	97-Military Affairs	The Department Of Military Affairs Should Strengthen Procedures For Monitoring Subrecipients	97.036	\$62,500	See 04-MA-05.
FY 00				(34,747)	
FY 02				(27,743)	
		Total Questioned Costs		0	

(3) Corrective action taken is significantly different from corrective action previously reported:

No findings for this section.

(4) Corrective action taken is significantly different from corrective action previously reported:

No findings for this section.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2004

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
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Material Weaknesses/Noncompliances

(1) Audit findings that have been fully corrected:

No findings for this section.

(2) Audit findings not corrected or partially corrected:

No findings for this section.

(4) Audit finding is no longer valid or does not warrant further action:

No findings for this section.

Other Matters

(1) Audit findings that have been fully corrected:

FY 03	03-MIL-1	The Department Of Military Affairs Should Strengthen Controls To Ensure Accurate Reporting On The Schedule Of Expenditures of Federal Awards	97.036	0	Resolved during FY 04.
FY 03	03-MIL-3	The Department Of Military Affairs Should Ensure All Federal Reports Are Submitted In A Timely Manner	97.036	0	Resolved during FY 04.

(2) Audit findings not corrected or partially corrected:

No findings for this section.

(3) Corrective action taken is significantly different from corrective action previously reported:

No findings for this section.

(4) Audit finding is no longer valid or does not warrant further action:

No findings for this section.

